

March 28, 2024

Mr. Neil Esho  
Secretary General  
Basel Committee on Banking Supervision  
Centralbahnplatz 2  
4051 Basel, Switzerland



**Re: Basel Committee on Banking Supervision Consultative Document: “Recalibration of shocks for interest rate risk in the banking book”**

Dear Mr. Esho:

The Institute of International Finance (IIF) welcomes the opportunity to provide comments to the Basel Committee (“BCBS” or the “Committee”) on the consultative document (CD): *Recalibration of shocks for interest rate risk in the banking book*. (IRRBB). We appreciate the work of the BCBS in seeking to ensure the regulatory standards remain appropriately calibrated and fit for purpose.

**Main Points:**

**We support the Committee’s proposal to switch from relative shock to absolute shock approach.**

- We fully agree with the Committee’s view that the current relative shock methodology does not appropriately reflect IRRBB in all interest rate environments and that the methodology needs to be amended to utilise an absolute shock approach.

**The confidence level should be kept at 99<sup>th</sup> percentile, not 99.9<sup>th</sup> percentile.**

- We do not agree with the proposal to amend the confidence level from 99% to 99.9% in order “...to maintain *sufficient conservatism in the proposed recalibration*”.
- We do not agree with the Committee’s view that the methodology change is more ‘accommodative’, thereby justifying the increase in the confidence level. The proposed methodology, utilising the same 99% confidence level, would not be less conservative than the current one. We note that the CD states that keeping the confidence level at the current 99% level would result in a decrease in shock factors for many jurisdictions, and would therefore lack conservatism. However, Table 8 in the CD shows the new methodology, utilising the 99% level, would be as severe on a relative basis as the current methodology — 14 increases (22%), 15 decreases (24%), 34 unchanged (54%). We refer to a publicly available study conducted by AFGAP<sup>1</sup> which states that “*applying the absolute shock methodology with a 99% probability to the previous data set (i.e., from 2000 till 2015) would have led to the same or higher shock levels (except for short shock for USD) than in*

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<sup>1</sup> Association Française des Gestionnaires Actif-Passif (AFGAP), “Updating the Regulatory Interest Rate Shock Scenario for EUR and USD (AFGAP Technical Paper)”, January 2024. Can be found on [afgap.org](http://afgap.org) website.

the BCBS 2016 methodology for EUR and USD” and a similar conclusion is true for the data set to 2022.

- We also do not consider there is a justification for increasing the confidence level from a methodology point of view. Once the confidence level at which the metric is calculated is set (99%), increasing the window adds more points to the actual distribution and represents the fluctuation and movements of interest rates more fully. Therefore, it does not seem conceptually correct to seek a change in the percentile value to mitigate the effect of the decrease in volatility in the current data. The additional increase in the confidence level to 99.9% is not necessary or justified.
- **Further the statement in the CD that the higher confidence level is required due to less conservative outcomes under the 99<sup>th</sup> level “despite more recent volatility in interest rates” is not supported by the data.** Although we observed the speed of rate hikes in 2022 and 2023 in many jurisdictions, that does not necessarily mean the volatility in interest rates is also higher than in the past.
  - For GBP, Annex 1 shows that while the peak of the volatility short shock (Graph 1) is highest in 2008-2009, the long shock (Graph 2) and the parallel shock (Graph 3) are highest in October 2022. It is considered that the peaks in October 2022 were caused by the mini-budget crisis, which was an idiosyncratic event for UK.
  - The AFGAP analysis (page 5)<sup>2</sup> shows that the peak of the EUR interest rate shock in 2022-2023 is lower than that experienced in 2008-2009, while the peak of the USD shock in 2022-2023 is at the same level of that in 2008-2009.
  - Overall, we question the notion of requiring these amendments based on “more recent volatility in interest rates.” This is particularly so for global financial institutions which have currency-diversified interest rate risks on their balance sheets, and adding up 99.9% percentile events (i.e., 6<sup>th</sup> worst value in the dataset) for each currency would be too conservative.
- **Conservatism is already embedded in the assumption of immediate shock.** Under the standardised approach, banks must determine the impact of these yield curve shocks on their economic value of equity (EVE) and net interest income (NII). The assumption that the calculated interest rate change occurs “overnight” adds additional conservatism to the calculated shock, since it disregards the ability of banks to adapt and position their balance sheets to deal with a changing rates environment, thereby reducing actual losses, in the six month time window. Empirical data in the study from AFGAP<sup>3</sup> suggest that interest rate shocks do not reach their peaks immediately. Therefore, this “extra-conservatism” effect was already present in the previous methodology, and the additional conservatism incorporated in proposing a larger confidence level of off 99.9<sup>th</sup> percentile value is neither justified nor appropriate.
- In addition, we consider that the proposal to use a 99.9<sup>th</sup> percentile confidence level is inconsistent with the calibration used in other Basel frameworks and specifically in FRTB, raising concerns about the overall consistency of the Basel 3.1 framework. In particular,

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<sup>2</sup> ibid

<sup>3</sup> ibid

Basel 3.1 allows banks, subject to conditions, to transfer interest rate risks in the banking book to an internal risk transfer desk in the trading book. In the trading book, interest rate risks are then subject to significantly lower pillar 1 shocks under FRTB. While there is already a difference between IRRBB and FRTB shocks under the current calibration, we are concerned that the proposed calibration increases the disconnect between those frameworks. We consider that some consistency between the IRRBB and FRTB frameworks is crucial to avoid introducing incentives for regulatory arbitrage and to ensure a harmonised approach to risk management.

#### **Threshold for the outlier test should be reviewed**

- We note that the BCBS' proposal will result in significantly higher shocks being applied but that the Committee is not proposing to adjust the 15% Tier 1 capital calibration of the EVE SOT. We consider that it would be inappropriate if the number of banks that are captured by the outlier test increases because of the technical amendments. We consider that the calibration of shocks and supervisory limits should move in parallel to ensure consistency between these key elements and to ensure the number of outliers remains the same.

#### **Other Points:**

##### **The 50bp rounding is excessive and unjustified.**

- We also have concerns that the increase in the confidence level combined with the current rounding methodology (apply rounding to nearest 50bp), may have the potential to amplify shock sizes. The use of a 99.9th percentile already encompasses very extreme scenarios, and given the current rounding methodology for some shock levels, a minor disparity in the shock has the potential to result in either rounding up or down resulting in materially different outcomes, and possibly leading to unrealistic shock values. While our major point is that it is necessary to address the unjustified proposal to increase the confidence level, we also suggest that, in any circumstances, in order to reduce the distortion introduced by the rounding methodology, a reduction to the rounding increment would be justified. Under the current rounding methodology, an only 1bp difference in a pre-rounded number (i.e., 224bp vs 225bp) would result in 50bp difference just due to the rounding.

##### **Regularly review the time series**

- In order to maintain a timely approach to the calculation methodology we suggest undertaking regular reviews of the time series utilized to perform the calculations. We suggest utilizing a consistent time period of (up to) 20 years of data and at regular intervals (e.g. perhaps every 4 or 5 years) amending the data series to maintain timeliness. Therefore, the initial data set under the updated standard could require utilization of data from Jan 2004 to December 2023 (to ensure the most recent data). Then a review could be undertaken during, for example, 2028 to consider the efficacy of the updated standard and at that time amend the time series to Jan 2008 to December 2027, and so forth at similarly regular intervals.

##### **Data Transparency:**

- Finally, industry is concerned with the lack of transparency and rationale behind some elements of the calibration of this standard. We therefore encourage the Basel

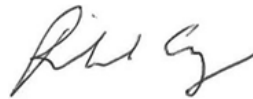
Committee to improve transparency in the assumptions, considerations, and calculations behind the proposals. This refers particularly to substantiating the choice of the time buckets used, the usage of 50bps rounding as well as the time window to define the time series of rate changes (6 months). Each of the mentioned items has a non-negligible impact on the final calculation. We also request that the Committee disclose underlying datasets and pre-rounded numbers for transparency. Such transparency would enable the Committee and the industry to work together to undertake further analysis and identify potential unintended problems in the methodology, such as the one identified in this consultation related to the low interest rate environment.

Thank you for your consideration of these comments. In particular, in light of the arguments presented above, we would strongly urge the Committee to reconsider the proposal to increase the confidence level to 99.9<sup>th</sup> percentile and to retain the 99<sup>th</sup> percentile level. On behalf of the IIF membership, we hope that these global industry perspectives will contribute constructively to your efforts. We would be very happy to discuss any of our comments further or to assist in any way. We invite you to contact Andrés Portilla ([aportilla@iif.com](mailto:aportilla@iif.com)) or Richard Gray ([rgray@iif.com](mailto:rgray@iif.com)) should you have questions or comments.

Yours Sincerely,



Andrés Portilla  
Managing Director and  
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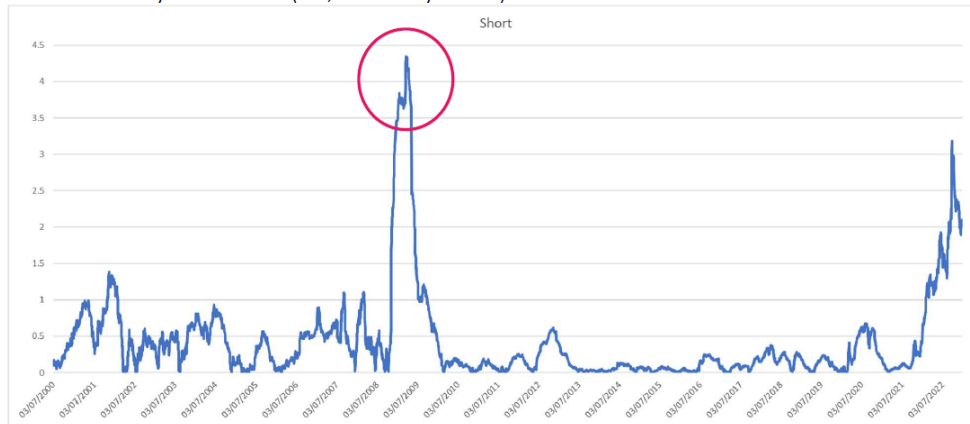


Richard Gray  
Director,  
Regulatory Affairs  
Institute of International Finance

## Annex 1 - Historical data analysis for GBP (Source: NatWest).

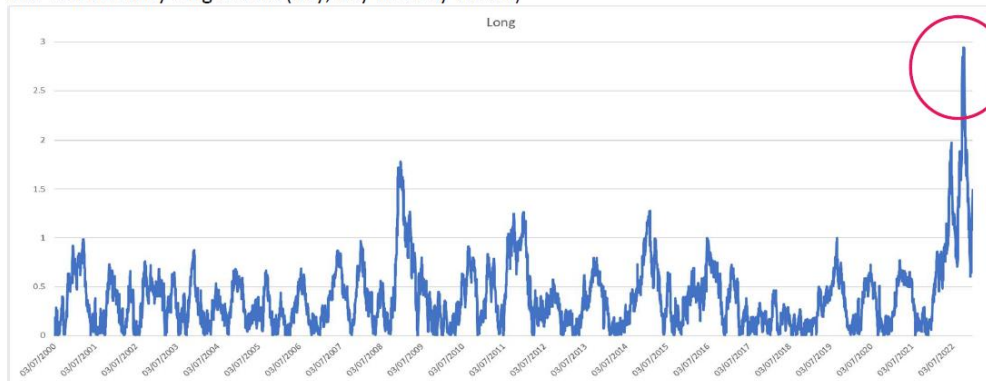
### Graph 1

GBP 6m volatility short shocks (3m, 6m and 1y tenors)



### Graph 2

GBP 6m volatility long shocks (10y, 15y and 20y tenors)



### Graph 3

GBP 6m volatility parallel shocks (all tenors)

